

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 03-0450
Adjusted Gross Income Tax
For the Years 1999, 2000, 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Prospective Treatment of Taxpayer's Adjusted Gross Income Tax Liability.

Authority: IC 6-8.1-3-3; IC 6-8.1-3-3(b); City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax 1998).

If the Department determines that sales of software maintenance contracts are subject adjusted gross income tax, taxpayer maintains that it is entitled to prospective treatment of those determinations.

II. Tax Administration - Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2(b).

Taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer consists of several corporations engaged in various businesses. As part of its businesses, taxpayer bundles computer software applications and hardware equipment packages, which are then resold. In addition, with respect to the packages, maintenance contracts are also sold. The contracts include software updates and technical service assistance. Most services are provided by the taxpayer in Indiana.

For purposes of adjusted gross income tax, taxpayer treated the receipts of the maintenance contracts as occurring in the state in which the customer used the software. Therefore, certain receipts were treated as out-of-state sales for adjusted gross income tax purposes. However, upon audit, Department treated the amounts received under the maintenance contracts as being sales of taxpayer in Indiana, and thus Indiana sales for apportionment in determining adjusted gross income tax.

Previously, taxpayer had protested the same issues with the Department. The Department previously sustained taxpayer's protest in a Letter of Findings. Taxpayer protests both the imposition of taxes and penalties by the Department, and requests prospective imposition of these taxes with respect to the transactions in controversy.

I. Prospective Treatment of Taxpayer's Adjusted Gross Income Tax Liability.

DISCUSSION

Taxpayer protests the Department's assessment of the adjusted gross income tax with respect to sales of software maintenance contracts where the services are performed in Indiana, but the software is used out of state.

Taxpayer had previously protested a Department assessment on the same issues, and the Department had sustained taxpayer's protest. The previous Letter of Findings had treated the sale of the maintenance agreements as sales of tangible personal property. For AGI purposes, these sales were out-of-state sales that were not included in the numerator of the Indiana sales factor. The Department has reconsidered this position and determined that the maintenance contracts are primarily the provision of services within Indiana, even if the service is provided for tangible personal property used outside Indiana. Thus, the sales of software maintenance which had previously been treated as non-Indiana sales were changed to Indiana sales for adjusted gross income tax under current Department interpretation.

Under IC 6-8.1-3-3, the Department of Revenue is without authority to reinterpret a taxpayer's tax liability without promulgating and publishing a regulation giving taxpayer notice of that reinterpretation. IC 6-8.1-3-3(b) states that "[n]o change in the department's interpretation of a listed tax may take effect before the date the change is (1) adopted in a rule under this section or (2) published in the Indiana Register"

In City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax 1998), plaintiff taxpayer argued that the Department could not impose gross income tax on the gain realized from the sale of tax-exempt bonds, because that gain had been treated as exempt for 42 years. Id. at 1128. Plaintiff taxpayer argued that, in the absence of a new rule or regulation, the Department's assessment of gross income taxes against the gain realized from the sale of the tax-exempt bonds was invalid. Id. at 1129. The Tax Court found that – despite the intervening adoption of regulations to the contrary – the Department could not impose the additional taxes when the Department had permitted plaintiff taxpayer to claim an exemption from the taxes subsequent to the adoption of the intervening regulations. Id. Nevertheless, the Tax Court also held that plaintiff taxpayer, having been placed on notice of its additional tax liability, was responsible for paying the tax on a prospective basis. Id.

In this case, taxpayer had claimed the sales of software maintenance contracts as non-Indiana sales were exempt in accordance with a Department Letter of Findings, and was entitled to rely on the previous Letter of Findings with respect to the issues protested therein, and therefore is not taxable for the years in question. However, for all tax years after the audit period, taxpayer is subject to adjusted gross income tax with respect to the software maintenance contracts.

FINDING

Taxpayer's protest is sustained, subject to the conditions listed above.

II. Tax Administration-Penalty

DISCUSSION

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2. In addition, 45 IAC 15-11-2(a) provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has presented evidence that it reasonably relied on the Department's prior Letter of Findings with respect to the returns in question. Accordingly, the penalty for negligence is waived.

FINDING

Taxpayer's protest is sustained.